



## Tax Laws Amendment (Budget Measures) Bill 2008

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## Tax Laws Amendment (Budget Measures) Bill 2008

**Date introduced:** 27 May 2008

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** Royal Assent, although the substantive provisions (other than items 6, 10 to 12 in Schedule 1) have retrospective effect from 7.30 pm (AEST), 13 May 2008<sup>1</sup>.

**Links:** The [relevant links](#) to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at <http://www.aph.gov.au/bills/>. When Bills have been passed they can be found at ComLaw, which is at <http://www.comlaw.gov.au/>.

### Purpose

This Bill amends taxation legislation to give effect to some of the policy initiatives announced as part of the 2008–2009 Commonwealth budget. The specific pieces of legislation amended are:

- the *Fringe Benefits Tax Assessment Act 1986* (FBTAA)
- the *Income Tax Assessment Act 1936* (ITAA36), and
- the *Income Tax Assessment Act 1997* (ITAA97).

The proposed amendments affect the tax treatment of:

- employee share schemes
- some fringe benefits provided to employees that are currently concessionally taxed, and
- the depreciation period for computer software.

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1. Date of announcement.

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## Background

### Fringe benefits

Fringe benefits tax (FBT) is a tax payable by employers on the value of certain benefits, ('fringe benefits'), which have been provided to employees, or to associates of those employees, in respect of their employment. The principal legislation dealing with FBT is the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) and its regulations.

Briefly, the proposed changes in the Bill will tighten the current exemptions under the FBTAA. It will restrict the FBT exemption for eligible work-related items such as laptop computers to items that are principally used for work related purposes. It will also tighten the FBT exemption for private use of business property by excluding meals provided as part of a salary sacrifice arrangement (known as meal cards).

### Employee share schemes

In 2000 the House of Representatives Standing Committee on Employment, Education and Workplace Relations found that there is no single type of employee share plan. While the plans can be structured in different ways they do however all have three elements in common:

- they aim to transfer equities to employees
- the transfer is on favourable terms to both employer and employee, and
- the recipient of the equities is an employee of the person providing the equities or other equity related securities such as options or warrants.<sup>2</sup>

Employee share ownership schemes might also be thought of as simply another instance of employers rewarding employees with non-wage financial entitlements, a labour management practice that stretches back well over one hundred years. While the receipt of wages gives every employee a direct stake in the ongoing financial success of their employer, the literature suggests that forms of additional, non-wage financial participation in the employer enterprise, such as profit-sharing, have been in existence since at least the mid-eighteenth century.<sup>3</sup>

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2. House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Shared Endeavours – Inquiry into employee share ownership in Australian enterprises*, Canberra, September 2000, p. 2.

3. Jarrod Lenne, Richard Mitchell and Ian Ramsay, 'Employee share ownership schemes in Australia: A survey of key issues and themes', *Research Report*, Centre for Corporate Law and Securities Regulation and Centre for Employment and Labour Relations Law, University of Melbourne, 2005, p. 8.

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Briefly, the Bill proposes two amendments that affect employee share plans. It would:

- end the current double taxation of the proceeds of employee share plans by amending the capital gains provisions in the ITAA97 to ensure a trustee or beneficiary of an employee share trust is not subject to capital gains tax (CGT) where an employee who exercises employee share scheme rights becomes absolutely entitled to the shares in the trust, and
- tighten the rules for choosing the time when the proceeds of these plans are bought to account for personal taxation purposes.

Depreciation of computer software

Under current taxation law computer software is depreciated, or written off, over two and a half years.<sup>4</sup> The proposed changes extend this period to four years. By way of comparison, computer hardware is also depreciated over four years.

Basis of policy commitment

These measures were announced in the 2008–2009 Budget speech and supporting documents and in the Treasurers' media releases of 13 May 2008.<sup>5</sup>

Position of significant interest groups/press commentary

Fringe benefits

By far the most controversial of the proposed changes are the changes to the taxation of fringe benefits. Press comment has reported several concerns about the proposed changes to the FBT rules:

- these changes may make it more difficult to construct an attractive employee remuneration package. This may be important in instances where Australian companies are competing for scarce skilled staff<sup>6</sup>

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4. Subsection 40-95(7), *Income Tax Assessment Act 1997*.

5. The Hon. Wayne Swan MP, Treasurer, 'Second reading speech: Appropriation Bill (No. 1) 2008–09, House of Representatives, *Debates*, 13 May 2008, p. 2600; 'Employee Share Schemes, *media release*, No. 44, Canberra, 13 May 2008; 'Fringe Benefits Tax (FBT) – Integrity Measures', *media release*, No. 48, Canberra, 13 May 2008; 'Depreciation period for computer software, *media release*, No. 49, Canberra, 13 May 2008.

6. Patrick Durkin, 'Fringe cuts too close for bosses', *Australian Financial Review*, 15 May 2008, p. 14; Ari Sharp, 'Employers grapple with FBT change: tax review', *Sydney Morning Herald*, 15 May 2008, p. 36.

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- a large majority of staff making use of the subsidised meals at work (ie meal cards) are low paid workers<sup>7</sup>
- these changes do not contribute to the simplification of the FBT regime,<sup>8</sup> and
- the proposed measures relating to meal cards will have a significant adverse affect on small business, mainly in inner city commercial areas.

Further, there was some concern that the proposed changes to the FBT regime may make salary sacrifice arrangements non-viable. However, the balance of press opinion is that there are still significant employer benefits that are either not subject to FBT or are taxed at a reduced rate.<sup>9</sup>

#### Employee share schemes

The proposed changes to the taxation rules applying to employee share plans have received mixed comment. The changes to end the double taxation of the proceeds of these schemes have been welcomed.<sup>10</sup>

However, the proposed legislative changes to force the point in time at which those receiving securities under a employee share scheme arrangement would be taxed has been deemed by some tax experts to be ineffective. They argue that the changes do no more than what the current law already does.<sup>11</sup>

#### Depreciation of computer software

It has been suggested that the proposed lengthening of the period over which the cost of computer software can be deducted is inappropriate. It has been claimed that the rapid rate of technical innovation means that business, especially small business, now change their software over a much shorter time period than the proposed four years.<sup>12</sup>

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7. Budget 08 the fallout. 'Bosses may have to make up for lost perks', *Sydney Morning Herald*, 15 May 2008, p. 7.

8. Ari Sharp, op. cit.

9. For example Caitlin O'Toole, 'Tighter tax net leaves room for successful sacrifice', *Australian Financial Review*, 20 May 2008, p. 8.

10. For example, Karian Barrymore, 'A budget to build on', *Herald Sun*, 19 May 2008, p. 29 and John Kehoe, 'Closing of loophole bemuses lawyers', *Australian Financial Review*, 15 May 2008, p. 12.

11. John Kehoe, op. cit.

12. Patrick Durkin, op. cit, and Jacob Saulwick, 'Fringe benefits saving brings \$1.4bn saving', *Sydney Morning Herald*, 14 May 2008, p. 2. However the Minister's second reading speech indicates 'small businesses are generally not likely to be impacted' by this particular measure. The Hon. Wayne Swan MP, op. cit., p. 44.

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## Pros and cons

The proposed measures will increase tax revenue and reduce government expenditure. However, as noted above, there may be some unintended consequences of the proposed changes.

## Coalition commitments

The Coalition's views on this Bill were summarised during the second reading speech of Mr Michael Keenan MP as follows:

- the Coalition supported the proposed changes to the rules governing the taxation of the proceeds of employee share plans, but noted that these changes were, in fact, current policy<sup>13</sup>
- the Coalition opposed the proposed changes to the FBT regime for many of the reasons noted above. It also criticised the FBT regime as being too complex,<sup>14</sup> and
- the Coalition also opposed the lengthening of the depreciation period for computer software.<sup>15</sup>

During the second reading debate in the House of Representatives, the Coalition called for the Bill to be referred to the Senate Economics Committee for further examination.<sup>16</sup>

## Financial implications

The Explanatory Memorandum notes that there will be minimal financial consequences arising from the proposed changes to the FBT regime and the rules governing the taxation of the proceeds arising from employee share schemes. However, the cumulative gains in revenue arising from the lengthening of the depreciation period for computer software from two and a half to four years between 2008–2009 and 2011–2012 are \$1.3 billion, as follows:<sup>17</sup>

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13. Mr Michael Keenan MP, Second reading speech: Tax Laws Amendment (Budget Measures) Bill 2008, House of Representatives, *Debates*, 28 May 2008, p. 80.
  14. *ibid.*, p. 79.
  15. *ibid.*, pp. 80-81.
  16. *ibid.*, p. 81.
  17. Explanatory Memorandum, Tax Laws Amendment (Budget Measures) Bill 2008, pp. 3-5.

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Table 1: Revenue gains from computer software measure

Year	2008-09	2009-10	2010-11	2011-12
Revenue Gain \$m	15	300	681	318

Source: Explanatory Memorandum<sup>18</sup>

## Key issues

A significant issue connected with the proposed changes in FBT is that of a double tax benefit. This occurs when a person pays for an asset, say a laptop computer, and claims a relevant tax depreciation deduction. They then receive reimbursement by their employer for this purchase through a salary sacrifice arrangement. The employer then claims an FBT exemption for this expenditure. The proposed changes in the Bill will tighten the rules so that depreciation benefits will be removed on work related items that are also FBT free. In addition, the FBT exemption will only apply to work related items used primarily for employment.

As Senators and Members would be aware, if a person salary sacrifices an amount, the amount forgone is not subject to income tax. If it is also not subject to FBT or company tax then it is income that is effectively not taxed. The example above of the laptop computer illustrates how personal income that normally would be subject to income tax has avoided that impost. It can be argued that such procedures are undue avoidance of income tax.

## Main provisions

Schedule 1—Fringe benefits tax and employee share schemes

Part 1—Fringe benefits tax and related measures

Meal cards

**Section 41** of the FBTA provides an FBT exemption for food and drink provided by an employer to an employee on an employer's premises. **Item 2** inserts **new subsection 41(2)**. Its effect is that the FBT exemption will no longer apply to food or drink provided to an employee as part of a salary sacrifice arrangement. This amendment applies to food

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18. *ibid.*, p. 5.

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and drink provided after 7.30 pm (AEST) on 13 May 2008, ie from the commencement of the Treasurer's 2008–2009 Budget Speech (**item 3**).

#### Exemption for eligible work-related items

Section 58X of the FBTA exempts from fringe benefits tax certain employment-related benefits provided by an employer to an employee (but not to the employee's associates). The benefits include laptop computers, portable printers, electronic diaries and mobile phones. Although the exemption was introduced in the expectation that any private use of the benefits by employees would be incidental to their employment use, the current wording of section 58X FBTA does not specify the amount of employment use required for the benefits to be exempt.<sup>19</sup> In particular, the use of the expression 'in respect of the employee's employment' in the current subsection 58X(1) appears to require a connection between the provision of the benefit and the employment, rather than a connection between the use of the benefit and the employment.

**Item 4** repeals **subsections 58X(2), (3) and (4)** and substitutes new text. The main effect of these amendments is to redefine what an 'eligible work related item' may be for FTBAA purposes<sup>20</sup> and to ensure that the above mentioned exemption from FBT is only available if this item is primarily for use in the employee's employment. These amendments apply from 7.30 pm, (AEST) on 13 May 2008 (**item 5**).

#### Income tax for eligible work-related items

**Item 8** amends **section 40-45** of the *Income Tax Assessment Act 1997* (ITAA97). The function of this particular section is to specify assets to which **Division 40** of the ITAA97 does not apply. Briefly, under this Division a deduction is available to the taxpayer for various capital expenses.

The effect of **item 8** is to deny a personal income tax deduction in respect to eligible work related items as specified under **section 58X** of the FBTA. That is, an employee would not be able to claim a deduction for the decline in value for an eligible work related item (such as a computer) where the item is provided as a fringe benefit and the benefit is exempt from FBT under section 58X. This amendment applies from 7.30 pm, AEST on 13 May 2008 (**item 9**).

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19. Although note the exception for phones. Subsection 58X(3) requires that mobile phones or car phones are only eligible work related items if the phone is primarily for use in the employee's employment.
  20. The new list of eligible items includes portable electronic devices, computer software, protective clothing, briefcases and tools of trade. It has been modified to take account of technological changes.

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## Part 2—Employee share schemes

**Section 139E** of the *Income Tax Assessment Act 1936* provides that an employee acquiring a share or a right in a company through an employee share scheme (ESS) may make an election to choose between two available tax concessions. **Items 10** and **11** amend this section so that the method of election is more transparent. Under **new subsection 139(2)** an election to be taxed upfront on shares or rights is made by making the election and including the amount of discount in the income tax return of the year when the shares were acquired. Under the current wording of the section such an election by the taxpayer is not required to be lodged with the tax return or otherwise provided to the Commissioner. The Explanatory Memorandum states that there is a risk with the existing election mechanism whereby taxpayers may seek to manipulate when the amount of the discount is included as assessable income and thereby reduce their liability for tax.<sup>21</sup>

**Item 13** states that the amendments in **items 10** to **12** apply to the 2008–09, and later, income years. Effectively, this means from 1 July 2008 for most taxpayers.

**Item 14** repeals and replaces **subsection 130-90(3)** of the ITAA97 in order to expand the capital gains tax (CGT) relief to certain ESS. Under the existing provision a trustee or beneficiary of an employee share trust is provided with relief from CGT when an employee becomes absolutely entitled to ESS shares or rights held in the trust. However the CGT relief does not extend to shares held in the trust that the employee acquired by exercising rights they acquired under an ESS. **Item 14** would extend CGT relief to this category. Its effect is from 7.30 pm (AEST) on 13 May 2008 (**item 15**).

## Schedule 2—In-house software

**Item 1** amends **subsection 40-95(7)** of the ITAA97 to extend the period of time over which computer software must be depreciated from two and a half to four years. The amendment applies from 7.30 pm, (AEST) on 13 May 2008 (**item 2**).

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21. Explanatory Memorandum, p. 18.

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